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Paper Review "Financial Liberalization, Crisis and Restructuring: A Comparative study of bank performance and bank governance in South East Asia

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This paper examines the impact of changes in bank governance on bank performance for a sample of commercial banks operating in South East Asia between 1990 and 2003. To meet their objective, authors collect data from Bankscope and IBCA databases for bank financial statements whilst macroeconomic data were obtained from the IMF International Financial Statistics and the Asian Development Bank. To qualify bank ownership, authors relied on the aforementioned databases, bank websites, and academic sources that have detailed changes in banking ownership including privatizations.

Authors' dataset covers 231 commercial banks between 1990 and 2003 that yielding a sample of 2030 observations. Countries included for study are; Indonesia, Korea, Malaysia, Philippines and Thailand. The dataset used is an unbalanced panel; however, authors explain why there are changes in the sample they use.

The paper is organized into seven sections. The introduction that provides a helpful summary of the key issues on South East Asia banking systems especially for readers who are unfamiliar with the topic. The other parts of the paper are preferred econometric framework, data classification and analysis, financial deregulation, bank efficiency and productivity in SE Asia, governance and bank performance: an agency perspective, Empirical results, and conclusion.

The authors' findings support bank privatization programs, repeal state ownership on economic grounds, and suggest the potential benefits of foreign ownership may take longer to be realized. For domestic private owned banks, the challenge is improving the bank efficiency.

Authors estimate various models for their study. These include the model specification for the alternative profit function, technical inefficiency effects model, impact technical change on bank profitability model, and the rate of inefficiency change, which all shown here:

Model 1: specification for the alternative profit function

$$\begin{aligned}
\ln(\mathrm{OP}/p_2 z_2) = {} & \alpha + \tau_1 T + \frac{1}{2}\tau_{11}T^2 + \sum_{i=1}^{3}\beta_1 \ln(Q_i/z_2) + \sum_{k=1}\psi_k \ln(P_k/P_2) \\
& + \sum_{r=1}\phi_r \ln(z_r/z_2) + \sum_{i=1}^{3}\lambda_i \ln(Q_i/z_2)T + \sum_{k=1}\lambda_k \ln(P_k/P_2)T \\
& + \sum_{k=1}\lambda_i \ln(z_i/z_j)T + \frac{1}{2}\sum_{i=1}^{3}\sum_{j=1}^{3}\theta_{ij}\ln(Q_i/z_2)\ln(Q_j/z_2) \\
& + \frac{1}{2}\sum_{k=1}\sum_{m=1}\psi_{km}\ln(P_k/p_2)\ln(P_m/p_2) \\
& + \frac{1}{2}\sum_{r=1}\sum_{s=1}\phi_{rs}\ln(z_r/z_2)\ln(z_s/z_2) \\
& + \sum_{k=1}\sum_{r=1}\Omega_{kr}\ln(P_k/P_2)\ln(z_r/z_2) \\
& + \sum_{i=1}^{3}\sum_{r=1}\kappa_{ij}\ln(Q_i/z_2)\ln(z_r/z_2) \\
& + \sum_{k=1}\sum_{i=1}^{3}\varpi_{ki}\ln(P_k/P_2)\ln(Q_i/z_2) + \sum_{n=1}^{3}a_n\cos(x_n) + b_n\sin(x_n) \\
& + \sum_{n=1}^{3}\sum_{p=1}^{3}a_{np}\cos(x_n + x_p) + b_{np}\sin(x_n + x_p) \\
& + \sum_{n=1}^{3}\sum_{p=1}^{3}\sum_{q=1}^{3}a_{npq}\cos(x_n + x_p + x_q) + b_{npq}\sin(x_n + x_p + x_q) \\
& + \sum_{i=1}^{4}\rho_i \ln(\mathrm{Risk}_i) + \sum_{i=1}^{5}\chi_i \ln(\mathrm{Country}_i) + \ln\varepsilon_c - \ln\mu_c, \qquad (1)
\end{aligned}$$

Model 2: Technical inefficiency effects model

$$\begin{aligned}
\mathrm{Ineff}_{it} = {} & \delta_0 + \delta_1\mathrm{closed} + \delta_2\mathrm{absorbed} + \delta_3\mathrm{For_all} + \delta_4\mathrm{State_all} + \delta_5\mathrm{Sel_For} \\
& + \delta_6\mathrm{Sel_Pri} + \delta_7\mathrm{Sel_M\&A} + \delta_8\mathrm{Sel_Res} + \delta_9\mathrm{For_ST} + \delta_{10}\mathrm{Pri_ST} \\
& + \delta_{11}\mathrm{M\&A_ST} + \delta_{12}\mathrm{Res_ST} + \delta_{13}\mathrm{For_LT} + \delta_{14}\mathrm{Pri_LT} + \delta_{15}\mathrm{M\&A_LT} \\
& + \delta_{16}\mathrm{Res_LT} + \delta_{17}\ln(\mathrm{Assets}) + \delta_{18}\mathrm{Year} + \delta_{18}\mathrm{Year}_2 + W_{it}. \qquad (2)
\end{aligned}$$

Model 3: Impact technical change has on bank profitability

$$\frac{\partial \ln \mathrm{OP}}{\partial T} = \tau_1 + \frac{1}{2}\tau_{11}T + \sum_{k=1}^{2}\lambda_i \ln P_k + \sum_{l=1}^{3}\lambda_l \ln Q_l. \qquad (3)$$

Model 4: The rate of inefficiency change derivation

$$\frac{\partial \ln U}{\partial T} = -C_{it}\frac{\partial \mu_{it}}{\partial t}, \qquad (4)$$

where

$$C_{it} = \left\{1 - \frac{1}{\sigma}\left[\frac{\phi\left(\frac{\mu_{it}}{\sigma} - \sigma\right)}{\Phi\left(\frac{\mu_{it}}{\sigma} - \sigma\right)} - \frac{\phi\left(\frac{\mu_{it}}{\sigma}\right)}{\Phi\left(\frac{\mu_{it}}{\sigma}\right)}\right]\right\}$$

and $\phi(\cdot)$ and $\Phi(\cdot)$ denote the standard normal density and distribution functions, respectively. Productivity is the sum of technical change and inefficiency change.

Part one introduces the topic. Though to certain extent it successful in providing the insight of development of SE Asia banking system, it has less explanation on banking industry in this part of the world. Issues such as development of banks, differences of economy between countries under study, how and why crises occurred, does the crises affects all countries in the same way, and whether the measures taken after crisis are suitable for long sustainability of banks in this region and also practical to all countries were not explained by authors. This part also misses key issues like historical analysis and critical examination of the global financial crisis and bank failure around the world.

Part two discuss the preferred econometric framework, where authors presents methodology they use for estimating bank performance. Authors use stochastic frontiers and Fourier flexible functional form to estimate bank alternative profit efficiency. They mention the reason for using these models is to capture for two components error term. The part, however, do not explain how authors deal with econometric problems such as that of autocolleniarity, endogeniety and others econometric assumptions.

Part three of the paper present data classification and analysis where authors explain how they collect data, auditing it and analyzing. This part is rich enough as authors successful discuss about static governance indicators for each country, and restructuring process for SE Asia banks. They fall short, however, in method because the part lacking empirical evidence to show why country like Indonesia was in most severe crises and how this will affect their results if at all.

Part four discuss financial deregulation, bank efficiency, and productivity in SE Asia. Here authors examine the effects of financial deregulations on bank performance in developing countries based on various theoretical and empirical evidences. There is little explanation, however, in the way on how financial deregulations work in other part of the world, and if not, why? Authors supposed to discuss this in detail as it build ground for their discussion.

Part five talk about governance and bank performance taking an agency perspective. The theory they use is relevant as possibility of principal-agent problems in bank raises the question as to which appropriate governance structure for banks. Such informative on agency perspective, while informative, overlook critical discussion of the difficulties faced other stakeholders when banking sector experience crisis. In this part there is still some issues need to be explained by authors. For example, does governance mechanism only can ensure the safety investment? If not, what other mechanisms suggested for the safe investment?

Part six is presentation of the empirical results for the study, where authors successful describe and discuss the results. The results indicate the success of policies such as bank privatization, encouraging foreign bank entry, and restructuring national banking structures order profit efficient than a greater proportion of its competitors before privatization.

The final part (seven) of the paper conclude what authors investigate and discuss on relationship between bank governance and bank performance for sample of SE Asia banks from 1990 to 2003. Authors believe that, their results imply economic justification for the policy of bank privatization.

Overall, the paper succeeding in explaining the relationship between bank governance and bank performance in South East Asia taking into account liberalization, crisis, and restructuring. The authors show prominence and scholarly arguments in this area of finance. Thus, the paper therefore meets its objective and it is an important read for both academics and professional interested in this topic. The paper however would have more benefited if take into account issue that mentioned in this review. Specifically missing are interview –type studies that would the voice to those concerned in the bank operation. It also missing the list of banks studied that give other researcher to conduct further studies to the same banks.

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